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Chart in focus

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The end of negative ECB interest rates

German banks reduce their vault cash

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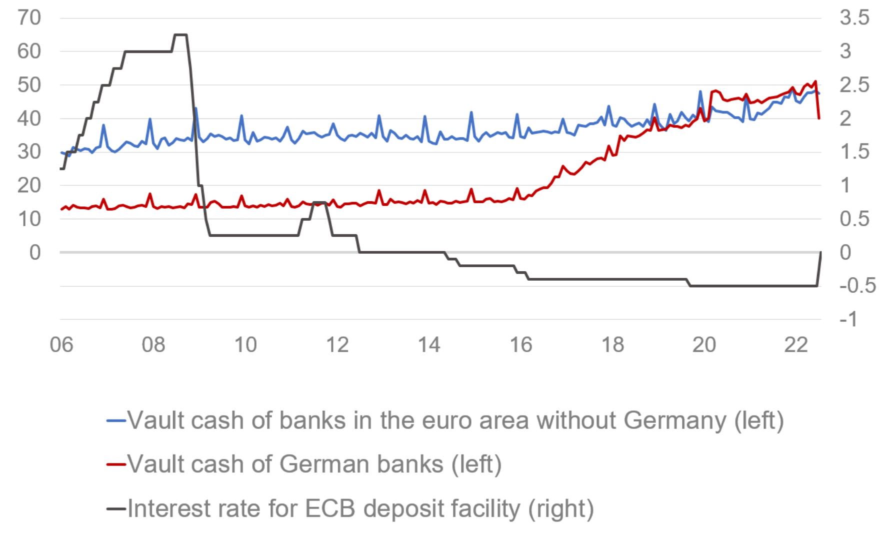
On July 21, the ECB announced that it would raise the interest rate on the deposit facility from -0.5% to 0%, effective July 27. By the end of that very month, banks in Germany had reduced their stock of banknotes and coins by a record EUR 11 billion. There is much to suggest that they will continue to reduce their non-interest-bearing cash holdings, as the ECB interest rate will rise further to 0.75% in mid-September.

The end of negative ECB interest rates: German banks reduce their vault cash

EUR billions (left), % (right)



Sources: ECB, Deutsche Bundesbank, Deutsche Bank Research

Until now, banks had never reduced their vault cash by more than EUR 5 billion – not even in a January when the "Christmas cash" flows back from the private sector. Overall, the trend had steadily pointed upward: since the ECB cut its deposit rate to -0.4% in March 2016, German banks had tripled their cash holdings from around EUR 17 billion to EUR 51 billion. By contrast, banks in the rest of the euro area only increased their vault cash by EUR 11 billion (+30%) over the same period. Moreover, they hardly reacted to the change in interest rates in July.

Since 2018, German institutions have held around half of all euro area banks' vault cash. In terms of total assets, however, Germany's share of the euro area banking market is equivalent to only a quarter.

Why German banks have reacted so much more strongly to the ECB's negative interest rates cannot be answered unambiguously, but we do get some insight by excluding potential drivers. In fact, two obvious explanations do not hold water. It is true that the German banking system holds the highest central bank reserves in absolute terms in a European comparison and thus had the most reason to avoid the negative interest rates by holding non-interest-bearing cash. However, French banks also have very high reserves. In addition, the reserves of the credit institutions here are only slightly above the European average when put in relation to total assets. The fact that people in Germany still often pay in cash and banks therefore have to keep cash on hand for their customers is also no good as an explanation: The turnover (value) of cash payments has not increased over the years. The strong growth of the euro currency in circulation and the development of bank balance sheets can also be ruled out as reasons for the difference in cash holdings between domestic and European banks.

The only remaining assumption is that more vault space is available in Germany or that other costs of cash storage – e.g. for transport or insurance – are lower. As a result, the interest rate threshold below which cash is cheaper to hold than central bank deposits (effective zero-lower-bound) would be reached sooner than in other European countries. Possibly with one exception: in Austria, too, banks multiplied their cash holdings when negative interest rates were introduced.

Even if the reasons for the different strategies of European banks are difficult to clarify, one thing is certain: German banks paid less negative interest to the ECB thanks to the increased cash hoarding. This is also supported by the denomination of the cash reflux in July, which consisted almost exclusively of EUR 200 and EUR 500 banknotes, which are preferably used for hoarding and not for payment.

However, the roughly EUR 50 billion in vault cash have to be put into perspective – German banks held reserves in the order of EUR 1.3 trillion at the central bank. Obviously, the effective zero-lower-bound was not yet undercut at -0.5% for German banks, despite first evasive action.